

On behalf of IRSAC's membership, I thank you, Madam Chairman and members of the IRS Oversight Board, for the opportunity to present our comments on the enforcement challenges facing the IRS. The Internal Revenue Service Advisory Council (IRSAC) was established in 1953. The IRSAC's primary purpose is to provide an organized public forum for IRS officials and representatives of the public to discuss relevant tax administration issues. Our group addresses broad tax administration topics or organizational issues. The IRSAC is composed of 23 individuals having a wide breadth of experience who bring diverse backgrounds to bear on the Council's activities. On behalf of the membership I would like to offer the following thoughts.

The IRSAC recognized that for our voluntary tax system to work it must include an effective compliance function that the public has confidence in. We also realize that the compliance function must recognize that most taxpayers attempt to comply with our complicated tax system and should not have their efforts made more difficult by an ineffective or intrusive compliance program. The IRSAC also understands that the IRS is required to offer taxpayers high quality service when they need it. These two primary missions are of equal importance and must be performed well, if taxpayers are to have confidence in the tax system they deserve. These challenges are difficult in and of themselves, but with the IRS having limited resources, they become even more difficult. It is for all of these reasons that IRSAC dedicated a great deal of its efforts this past year to examining the IRS compliance functions.

One of the most controversial compliance efforts the IRS began last year was the K-1 matching program. The IRSAC warned the IRS before this program began that there was the potential for big problems if the program was not properly designed and implemented. I think it is safe to say our warning was not heard and our concerns proved to be accurate. Everyone on IRSAC supports a K-1 matching program but only if it is done properly. K-1 matching is not like any other matching program and therefore needed more study and input from outside stakeholders before it was implemented. The unfortunate result of this lack of stakeholder involvement was a great deal of criticism from stakeholders, Congress, practitioners, and taxpayers. To the IRS's credit they temporally suspended the mailing of notices when it became apparent that the program was not working as it was intended.

While the IRSAC was critical of how the K-1 matching program began, we must offer our praise for the actions the IRS has taken subsequently. Immediately after the program was halted the IRS began to work with stakeholders to hear their complaints and to listen to how the program should be structured in the future. Let me share with you how they have worked with the IRSAC recently. First, a group of IRSAC members were invited to the Ogden Service Center to see how the K-1 matching program was being handled. We were given access to the IRS personnel that had front line responsibility for examining returns and sending out notices and responding to taxpayers. We learned a great deal about the process and problems these employees were facing. We have also received many briefings on the results of last years matching program. Finally, in December we were part of a working group that included AICPA, ABA, National Society of

Accountants, National Association of Enrolled Agents, National Association of Tax Professionals, and all relevant IRS personnel to help examine what went wrong last year and how the program should work in the future. We found this meeting to be very open and many good ideas were presented. I felt that at the end of that meeting a consensus of what an effective K-1 matching program should look like was in place. We hope that when we see the new K-1 matching program, it will be designed along the lines of what we discussed at our meeting. Our only regret is that this type of meeting did not take place earlier.

The National Research Program offers a great contrast to K-1 matching. What we saw in the development of NRP was a great deal of stakeholder involvement from the beginning of this program. This stakeholder involvement included not only its design, but also in how to explain to outsiders why this new program was needed. The IRSAC agrees that the IRS must begin a program to better understand its customer. One of the purposes of NRP is to better identify which taxpayer should be subject to an audit. The ability to better direct resources is going to be critical as the IRS is faced with tight budgets in the future. While the IRSAC supports NRP, we intend to keep a watchful eye on this program as it moves forward. As previously stated, we are pleased with how this program was designed and the goals of the program. However, the real test of the program is just beginning. As the NRP audits begin, they must be conducted in a professional and efficient manner. IRSAC expects to continue to monitor the NRP as we meet in the coming year.

IRSAC was also pleased to hear of some innovative ways that the IRS is trying to meet their compliance challenges. The IRS has partnered with the State of California in one of those initiatives. The IRS was furnished by California the sales tax records supplied to the state by businesses. The IRS then compared the revenue reported to the state with what that business reported to the IRS on their tax return for that same period. Where discrepancies were discovered the IRS began communicating with those businesses to determine if there was unreported taxable income. We believe that this type of program can help the IRS find potential unreported income with limited and better use of its resources. We would hope that more of these types of programs could be developed. IRSAC hopes that the IRS will continue to work with outside groups to see where information could be shared that would allow the Service to better identify potential compliance efforts.

Recently the IRS introduced a Voluntary Compliance Initiative targeted at abusive offshore credit card schemes. This is another example of how the IRS is attempting to better utilize its' limited resources to enhance compliance. This compliance goal is not only directed to improve compliance from the average taxpayer but also to help identify the groups promoting these shelters. Prior to this initiative the IRS has found it very difficult and very expensive to locate and identify these promoters. This program will benefit the taxpayer by offering penalty wavers in exchange for information identifying the groups that promote these shelters. This initiative should be judged based on how many promoters are identified, not by how many taxpayers come forward. Based on these

criteria, if this program proves to be successful, we suggest the IRS look for other opportunities to implement similar initiatives.

No discussion on compliance can be complete without discussing the Offer in Compromise program. The IRS has worked diligently to improve this program and with the establishment of the centralized processing centers, improvements have been made to the OIC process. However, IRSAC is still very concerned that this program consumes a high percentage of the compliance resources and serves a small percentage of the taxpayers. Making the process more efficient can only do so much. The real answer is to decrease the demand for the OIC program. IRSAC supports the proposed user fee as a way to decrease demand by, hopefully, removing many of the claims that should never be part of the OIC program. In addition IRSAC feels that the IRS must try to determine what is causing so many taxpayers to find themselves in a position where the OIC program is the only way to settle their account with the IRS. It is our understanding that today 25% of all compliance resources are allocated to the OIC program. Until the demands this program places on the IRS are reduced, IRSAC believes that the IRS will continue to have difficulty in effectively addressing other areas of noncompliance.

Finally, IRSAC agrees with the Oversight Board that the IRS needs adequate budgets to address a growing public perception of widespread noncompliance. A lingering problem facing the IRS today is that some taxpayers believe that they can get away with taking chances with their obligations to the federal government due to the low audit rate and lack of collection resources. Unfortunately in many cases these taxpayers are correct. A

big reason they are correct is that the IRS does not have adequate resources to keep pace with their increased workload. Without increased resources it will be difficult to change public perception and noncompliance problems facing the IRS could continue to grow at a pace that could undermine the entire voluntary tax system.

In closing I would again like to thank you on behalf of IRSAC's membership for the opportunity to be part of this hearing. IRSAC looks forward to our continued working relationship with the IRS and the Oversight board.